

U.S. Department of Housing and Urban Development
Community Planning and Development

Special Attention of:

Notice CPD-98-3

All CPD Division Directors

Issued: March 25, 1998

All State CDBG Grantees

All State Coordinators

Expires: March 25, 1999

Cross References:

Subject: Procedures for Closing State Community Development
Block Grant (CDBG) Program Grants

I. Purpose

This Notice provides policy guidance and procedural instructions for HUD Field Offices and State staff on how to close out grants awarded to States under the State Community Development Block Grant Program. This Notice replaces Notice CPD-86-12, entitled "Procedures for Closing State CDBG Program Grants," published on November 3, 1986.

II. Applicability

State CDBG Program grants are authorized under Title I of the Housing and Community Development Act of 1974, as amended. The Department's implementing regulations for administering these grants are found in 24 CFR Parts 91 and 570 (Subpart I). HUD and State staff must make the necessary reviews and audits to ensure that statutory and regulatory requirements governing CDBG grants have been satisfied prior to closing a State CDBG allocation.

III. General Criteria for Closing State CDBG Grants

A grant to a State may be closed when the State and Field Office staff determine that all of the following conditions have been met:

- A. The State has disbursed to recipient units of general local government all CDBG funds included in the Final Statement/Consolidated Plan for the fiscal year grant to be closed out under the agreement, except for funds remaining for state administrative expenses and audit;

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- B. Recipients have completed all activities and expended funds received and the State has made the required reviews and audits to determine whether recipients have satisfied the performance criteria in Section 104(e)(2) of the Act. Section 104(e)(2) reviews and audits must document that the State: distributed its CDBG funds in a timely manner; adhered to its method of distribution in the State's Final Statement or Consolidated Plan; carried out its certifications required by Title I for administration of State CDBG funds and complied with Title I and other program requirements in administering its State CDBG allocation, including appropriate reviews to ensure that all CDBG activities funded are eligible and meet a national objective; and
- C. The audit(s) of the State covers all funds in the allocation to be closed and there are no open outstanding monitoring and audit findings; or, where costs have been incurred since the most recent audit(s), the State is willing to enter into a written agreement with HUD, which will require the State to submit to HUD the amount of any costs which are disallowed by subsequent audits or HUD Field Office reviews.

IV. Documents and Reviews to assist in Determining Compliance with Program Requirements

When HUD determines that the State has met the criteria stated in Section III, steps may be taken to close out the grant. Generally, the necessary reviews to ensure compliance occur prior to the closing of the grant. However, it may be necessary in some instances to conduct a further in-house and/or on-site review prior to closing to verify those financial transactions that recently occurred or those transactions where the full amount will not be known until the date of closing.

In conducting the in-house review, the following documents may be used as resources: Final Statement (State CDBG allocation prior to FY 1995 will have a Final Statement); Consolidated Plan (Consolidated Plan for all grant allocations, beginning in FY 1995 and later, except for those states that received an exemption from submitting a Consolidated Plan in FY 1995); Grants Management System (GMS); approval letter; grant contract; annual Performance and Evaluation Reports (PERs); Integrated Disbursement and Information System (IDIS); audit reports; monitoring letters and reports; and any other documents pertinent to the grant agreement.

A. Final Statement/Consolidated Plan

Until FY 1995, the Final Statement was the key document submitted by States to HUD Field Offices to describe their objectives and projected use of CDBG funds for a program year.

For a State, this document contains a description of the method by which the State distributes its CDBG funds to units of general local government. The Final Statement has now been replaced by the Consolidated Plan. Generally, the Consolidated Plan may cover a period of up to five years. However, the Consolidated Plan contains a one-year action plan (and certifications), which details how the appropriation for the fiscal year will be distributed to units of general local government.

B. Performance and Evaluation Report (PER)

The Performance and Evaluation Report (PER) is the document used by States to report to HUD on their accomplishments under the State CDBG Program. This report contains information on recipients and activities funded and proposed and actual accomplishments under the grant agreement. A State submits a separate PER for each allocation that is still open.

The Consolidated Plan established the single submission and reporting requirements for four of HUD's programs: CDBG, ESG, HOME, and HOPWA. States will soon be able to use the Integrated Disbursement and Information System to provide HUD with a wealth of statistical information on their progress under these grants. The standard forms used for reporting performance (the PER for the State CDBG Program) will eventually no longer be needed for reporting on progress. However, until the States are in IDIS production mode, there is still a need for manual reporting on recipients funded and their accomplishments under the State CDBG Program. The Department's memorandum of December 5, 1996, entitled "Interim Performance Reporting for 1996 Consolidated Plan Program Year" provides instructions to States and other grantees on performance reporting for the consolidated program. Until the IDIS is fully operational for State grantees, States may continue to use the PER to satisfy statutory and other reporting requirements under the Consolidated Plan for the State CDBG Program. Updated reporting guidance for States will be issued in the near future.

C. Grants Management System

The Grants Management System brings together core activities for CPD, including consultation with grantees, timely processing of grant awards, oversight of grantee compliance with regulatory and statutory requirements, and evaluation of grantees, under one technical system. The GMS data base contains a wealth of information on grantees' short and long-term goals and objectives, best practices implemented, monitoring findings and evaluations, and accomplishments under the grant agreement.

D. Audit Reports

The audit reports are critical for determining whether the State has met financial management requirements. The Single Audit Act prohibits HUD from requiring a State to obtain an audit covering only the CDBG Program. (HUD still has the authority to conduct or contract with an independent public accountant to audit a State's program. However, HUD must pay for the audit and it cannot duplicate any previous audit work on the State.)

In cases where the previous audit(s) fails to cover all grant funds under the agreement, the grant may still be closed, provided the State is willing to enter into a written agreement to remit to HUD any costs disallowed by a subsequent audit and sustained by HUD. This procedure is expected to be used in those cases where both the State and HUD want to proceed with the close-out before the next periodic single audit will be done covering the remaining grant funds not already audited.

The 1996 amendments to the Single Audit Act made significant changes to the audit requirements for States and local governments. A revised office of Management and Budget (OMB) Circular, A-133, was published in the Federal Register on June 30, 1997. In early FY 1998, HUD will issue revised regulations at 24 CFR Parts 84 and 85 to implement the new OMB Circular A-133 requirements. This new rule will replace the existing 24 CFR Part 44 regulations.

E. The Integrated Disbursement and Information System (IDIS)

The Integrated Disbursement and Information System (IDIS) is an integrated financial and programmatic information system designed to provide up-to-date information for HUD and grantees on recipients and activities funded and disbursement of grant funds for these activities. The IDIS will eventually contain all of the information now currently collected in various individual program performance reports such as the State Performance and Evaluation Reports. HUD staff will be able to use the IDIS to obtain reports on activities funded in a specific program year and funds expended for these activities.

A feature of IDIS is the first in first out (FIFO) drawdown process. Drawdown requests will automatically be paid for out of the oldest available allocation. The Line of Credit Control (LOCC) System will operate in the same manner for States. Entitlement communities have always operated in this manner. However, States were required to draw down their funds by grant allocation year. The FIFO process in IDIS and LOCCS will now automatically draw down funds from States' oldest allocation first. States need not wait until they "go live" on IDIS to

begin using the FIFO drawdown process; they may do so now. States may wish to close out older year grants from HUD in order to simplify the conversion to IDIS.

V. Expediting Close-Out of State CDBG Grants

In some situations, switching to a FIFO drawdown process now may allow States to drawdown and expend small amounts remaining in older year grants. These older grants may then be closed out rather than transferred into IDIS. The fact that LOCCS has "zeroed out" a given year's funds does not, by itself, mean that a given year's grant to a State may now be closed out; all activities funded from that year's allocation must also be completed. This can be problematic where a few slow-moving activities funded out of a year's allocation remain uncompleted by State grant recipients.

A State may delete activities from one year's funding allocation and add the same activities to a subsequent year's grant. This ability can be used to hasten the completion of activities funded out of a given year's allocation. The unexpended portion of an open grant to a community can be terminated, and a like amount of funds could be awarded to the community from a more recent year's allocation. The now unobligated remaining funds from the old allocation can then be used to make a new award to another community.

How this can work is illustrated by the following hypothetical example. Town A received a \$330,000 grant from the State's 1991 allocation. The project is moving very slowly, and to date, only \$180,000 has been expended; the remaining funds are for an activity which has not yet begun because of a lawsuit. Town B has submitted an application for a \$150,000 grant in the 1997 funding competition; the activities proposed for funding are likely to be completed quickly, and rate well enough to be funded. The State could amend Town A's grant contract, terminating the \$150,000 worth of remaining 1991 funds and in its place awarding them \$150,000 worth of 1997 funds. The State could then award Town B a grant for \$150,000 from its 1991 allocation instead of its 1997 allocation. Once Town B completes its 1991-funded activities, the State can proceed to close out its 1991 grant from HUD.

Several factors must be considered in applying this approach. The State may need to authorize the reimbursement of pre-grant agreement costs for Town A, to the extent that Town A already has placed CDBG funds under contract at the local level prior to the award of the 1997 funds. The State must also ensure that Town A's activities are consistent with the State's 1997 Consolidated Plan method of distribution, and that Town B's activities are consistent with the State's 1991 method of

distribution. Finally, the State must be satisfied that Town B will complete its activities more quickly than Town A will; otherwise, nothing is gained.

This approach cannot be applied to activities for which funds have already been drawn down and expended. A partially or fully-completed activity cannot retroactively be given the identity of some previous allocation. If Town C received a 1994 grant, but has already completed its activities and expended all its grant funds, the State could not retroactively "switch" Town C's grant to the 1991 allocation in order to give Town A \$150,000 from the State's 1994 allocation.

States may not move funds from one year's allocation to another. Further, States must account for funds by allocation year for national objectives and other program requirements on a program year basis. For instance, a FY 1995 grant to a local government will be reported as part of the FY 1995 allocation even though funds from FY 1990 or 1993 may be used to pay for drawdown requests for that grant. Further, States must ensure that their financial accounting systems account for grants and activities on a program year basis and there is a linkage between their systems and IDIS.

VI. Rule Governing Obligation/Expenditure of CDBG Funds

The National Defense Authorization Act for Fiscal Year 1991 (P.L.101-510) established rules governing the availability of appropriations for obligation and expenditure. This legislation mandates that all CDBG funds must be appropriated and obligated within a certain time period. On September 30th of the fiscal year after the period of availability for obligation of a fixed appropriation account ends, the account shall be closed and any remaining balances (whether obligated or unobligated) in the account shall be canceled and thereafter shall not be available for obligation or expenditure for any purpose. CDBG funds remaining in the grantee's account after this time period will be deobligated by HUD. The appropriation period for CDBG funds is three fiscal years, the year the funds are actually appropriated plus two additional years. Grantees now have a total of 8 years to obligate and expend CDBG funds, counting the appropriation period of three years and the additional five years for expenditure of funds mandated by this legislation.

The legislation was enacted in FY 1991, and therefore impacted funds dating as far back as 1989 which were available through the 1991 fiscal year. However, supplemental legislation (P.L. 102-27) was enacted on April 10, 1991, which exempted certain funds. This Administrative procedure stated that 'Community development grants' and 'Urban development action grants' for prior fiscal years shall be exempt, effective as of March 5, 1991, from the application of provisions of section

1405(b)(4) and (b)(6) of P.L.101-510 (104 Stat.1670) and Section 1552 of title 31,USC, and shall remain available until expended for the purposes for which originally obligated. only those funds which were obligated as of March 5, 1991, are exempt. All other CDBG funds, including 1989, 1990, and 1991 funds that were not obligated by March 5, 1991, as well as all 1992 and later funds remaining in the grantee's account after this time; are subject to cancellation, pursuant to P.L. 101-510.

VII. Financial Review

Field Office and State staff should be able to verify the following with regard to the State's financial records:

A. Administrative Costs

No more than two percent of the total grant allocation and program income earned was used for eligible State administrative expenses and the State has met the required match provision for these funds. In calculating the two percent eligible for administrative expenses, States may include two percent of program income returned by units of general local government to the State after August 21, 1985, and two percent of program income received by units of general local government after February 11, 1991. For Fiscal Year 1984 and subsequent grants, States may use an additional \$100,000 of the grant which need not be matched. Administrative costs greater than \$100,000 must be matched on a dollar for dollar basis. The match may include any direct or indirect administrative costs the State pays for with State funds to carry out its responsibilities under the Act. In addition, the general administration expenses incurred by the State and its recipients should not exceed the overall twenty percent limitation.

The financial status report section of the existing PER, which is now a part of the Consolidated Plan Report, contains a line for reporting the total amount of the grant budgeted for administration. The actual amount used by the State for administration should be reported on the final performance report for the allocation. The IDIS system will allow a State to set aside its-administrative funds in a subgrant to itself. Technical assistance funds not awarded directly to recipient units of general local government but used by the State to provide such technical assistance can also be shown in the same manner.

B. Program Income

The State must have a system in place to effectively account for and manage all program income earned as a result of grant supported activities. This includes program income returned

from units of general local government to the State, as well as program income retained by units of general local government.

1. Program Income Returned to State

The financial status information in Part I of a State's PER contains a line item on total program income distributed within the program year. This amount does not include program income on hand at the State level which was not awarded to a recipient. It also does not contain any program income included in a state's revolving fund account. Program income in a revolving fund account is returned to the revolving fund account to continue the revolving fund specifically identified activities.

2. Program Income at Local Level

Program income received and retained by the unit of general local government before close-out of the grant is treated as additional CDBG funds and is subject to the requirements of the Act. A State can require its recipients to return all program income received back to the State. Program income retained at the local level must be tracked and used in accordance with program requirements. Program income amounts of less than \$25,000 during a single year is considered miscellaneous revenue and program requirements do not apply. Program income amounts that exceeds \$25,000 in a single program year must be tracked by the local government and State to ensure that Title I and other requirements are satisfied. Units of general local government must use any program income funds on hand prior to requesting funds from the State. The only exception to this requirement is in the case of revolving fund accounts.

3. Program Income Prior to FY 1993 vs. Program Income in FY 1993 and Beyond

In tracking and reporting the use of program income, it is important that States separately account for program income that was generated from grants the State received prior to FY 1993 and those grants received in FY 1993 and later. The applicability of CDBG program income requirements is different depending on the fiscal year of the State's allocation from which the program income was-generated. For allocations prior to FY 1993, Title I and other program requirements apply to program income collected during the life of the grant. At close-out, Title I and other program requirements apply only if:

- (a) The unit of general local government has another ongoing CDBG grant;
- (b) The program income is being used to continue the activity that generated the program income; or

- (c) The State has imposed additional requirements governing the use of program income.

Beginning with FY 1993 funding allocations and thereafter, any locally-held must always be used in accordance with Title I and other program requirements. Such program income will have to be tracked and reported to States as long as the program income exists.

VIII. Preparation of Financial Status Report

The State should be asked to complete a Financial Status Report. This report should be sent to HUD's Community Planning and Development Division within 30 days after the State has satisfied the criteria for close-out of its grant. All of the conditions set forth in Paragraph III of this notice must be satisfied prior to preparation of Financial Status Report. CPD must be able to verify that:

HUD has completed the necessary reviews to ensure that the State has fully satisfied Title I and other requirements governing the grant agreement; and

The audit reports on hand cover all funds under the grant agreement or the State is closing subject to a later audit.

States were previously instructed to use the Financial Status Report (Form 269) contained in 24 CFR Part 85 for their financial status reports (see Attachment I for a copy of Form 269). States were advised that completion of line items 10 columns "a" through "f" was not necessary for their submissions. States were required to complete only line item 10 "a" through "m" of column "g" which provides financial data on the total obligations, expenditures, and program income related to the grant.

States may continue to use Form 269 for financial reporting. However, because States are not required to follow 24 CFR Part 85, HUD cannot mandate that States use this form. Section 570.489(d)(2) allows States to use fiscal and administrative requirements applicable to the use of its own funds, adopt new fiscal and administrative requirements, or apply the provisions in 24 CFR Part 85. Therefore, a State may submit its own financial status report as long as the report contains the following:

There is a block on the form for signature by the certifying official that the report is accurate;

HUD is able to determine that the total grant allocation is consistent with the grant agreement amount;

Program income is accounted for;
The total amount expended is shown;

The State has estimated an amount for any third party claims remaining under the grant agreement; and

The total amount of any grant funds to be canceled is shown.

A. Review by Field Office

Upon receipt of the financial report, the CPD Field Office should review it for accuracy and consistency with other available information, including grant disbursement records, audit reports, and LOCCS. The State's financial report should indicate any amount of unused grant funds to be canceled. In the case of States using the Financial Status Report Form, the amount shown on line 10 "m" of column "g" of the form represents the amount of the unused grant to be canceled.

B. Preparation of Letter to be Attached to Financial Status Report

Because the Financial Status Report and/or state financial report may not contain a grant computation balance section and appropriate space for the HUD official to certify HUD's approval of the grantee's Financial Status Report, the Letter in Attachment II of this Notice has been designed to meet this need. The Certifying HUD Official should either be the Director of CPD or his designee. The Letter should be attached to the financial report to be forwarded to the Director, Accounting Division, Office of Comptroller for certification. A copy of the financial report, with the letter attached, must also be returned to the grantee to indicate HUD's approval of the grantee's financial report.

XIII. Recordkeeping Responsibilities

Section 570.490 of the State CDBG regulations describes the recordkeeping requirements governing this grant program. Generally, records at the State and local level, including supporting documentation, shall be retained for three years from close-out of the grant to the State, unless there are other statutory/regulatory provisions requiring a longer retention period. Field Offices should maintain all records concerning the termination and/or grant close-out in accordance with the disposition instructions contained in HUD Handbook 2225.6, Records Disposition Management: HUD Records Schedules.

IX. How to Obtain Additional Information

States should contact their respective Field Offices for further advice and guidance in closing State CDBG grants. Field Offices may contact the State and Small Cities Division, Office of Block Grant Assistance, Community Planning and Development, for further advice and guidance on closing State CDBG grants.

Attachments